

## **Methodical aspects of financial diagnosis of small and medium business**

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### **Abstract**

Small and medium enterprises are a fundamental part of the development of all sectors of the economy. World practice shows that significant reserves to increase production efficiency are laid in the process of restructuring state enterprises and expanding business. In such a situation, the activation cost lever is especially important, successfully affecting the performance of all participants in the proceedings. In these conditions, financial diagnostics of small and medium-sized businesses is especially important. The novelty of the study is the development of financial diagnostic methods for small and medium-sized businesses. Object of study: financial activities of small medium-sized businesses. The purpose of the study: conceptual approaches to organizing and conducting financial diagnostics of small and medium-sized businesses. Research objectives: to analyze the development trends of small and medium-sized enterprises in the Republic of Belarus, to generalize approaches to the financial diagnostics of small and medium-sized enterprises, to determine a comprehensive approach to financial diagnostics. Research methods: as the main methods used in economic analysis and synthesis, comparing, summarizing, studying the theoretical and methodological foundations of financial diagnostics, the main approaches to organizing and conducting financial diagnostics of small and medium-sized businesses; the work of domestic and foreign economists and practitioners in the field of scientific research. Results of the research: The lack of practical developments that fully characterize the methods of financial diagnostics made it possible to substantiate: the basic principles of organizing and conducting financial diagnostics; prerequisites for ensuring financial diagnostics; requirements for information about financial diagnosis.

**Key words:** small and medium enterprises, financial diagnostics, principles of financial diagnostics, necessary prerequisite for ensuring financial diagnostics, methods.

### **Introduction**

As a consequence of economic reforms has been a significant strengthening of the Azerbaijan Republic. In recent years, in order to reduce economic dependence on the oil sector, the development of small and medium enterprises in Azerbaijan has become one of the priority areas. In particular, the opening of state-owned industrial and manufacturing facilities, the development of agriculture entrepreneurs are given preferential credits, subsidies are provided. Until today, the National Entrepreneurship Support Fund under the Ministry of Economy has allocated more than two billion manats (over one billion dollars), almost 35 thousand

entrepreneurs. Simultaneously, the state holds a number of other activities in order to create in the country a healthy business climate.

However, it should be emphasized that only a change in ownership and investment growth in the economy pruner does not guarantee improved performance of small and medium-sized enterprises. High performance enterprise data can be achieved only in the case of the creation of appropriate conditions for continuous operation. This, above all, contributes to: the presence of a stable legislative framework governing economic activity; the formation of the necessary technical, human and financial capacity; the introduction of rational management systems.

Meanwhile, the world practice shows that significant reserves of increase of efficiency of production laid down in the restructuring of state-owned enterprises, expansion of business, increasing the number of small and medium non-state entities. In developed countries, the public sector is mainly owned enterprise key sectors of the economy (heavy industry, energy, transportation, military and aerospace production), whose share in the total volume is on average 10 to 20%.

As for the sphere of production of consumer goods and services to the population, there are mainly operated by private companies, medium-sized and small firms. Crucial prerequisites welfare enterprises are also strengthening the material interest of the members of the team in the final results of their work.

In such a situation it is particularly important activation cost leverage, successfully impacting on the performance of all areas of production. The solution to this problem depends largely on the implementation of a comprehensive scientific enterprise management system based on the use of data on the effectiveness of the decisions taken. It is no coincidence integrated management process involves the implementation of the current and subsequent control over the implementation of the planned tasks.

### **Prerequisites and rational organization of financial diagnosis - main trends**

Crucial prerequisites welfare enterprises are also strengthening the material interest of the members of the team in the final results of their work. In such a situation it is particularly important activation cost leverage, successfully impacting on the performance of all areas of production. The solution to this problem depends largely on the implementation of a comprehensive scientific enterprise management system based on the use of data on the effectiveness of the decisions taken. It is no coincidence integrated management process involves the implementation of the current and subsequent control over the implementation of the planned tasks.

However, these forms of control are not sufficient to fully determine the trend of enterprise development over a longer period. In most cases, do not reveal the causal relationships of interrelated categories, nature and consequences of the underlying processes that have an impact on the final results of operations.

In these conditions is particularly important financial diagnostics of business activities of small private enterprises, the functioning of which in modern economic conditions due to the difficulties of survival in the domestic and international market. The reasons for this phenomenon lie in the lack of improvement and frequent changes in legal acts regulating their activities, as well as in relations with the State, credit institutions and business partners. In some cases, competitiveness remains low because businesses have only a small amount of capital, insufficient qualified personnel sometimes use outdated technology.

In Azerbaijan, a significant portion of non-state enterprises, about 80% are small businesses. In the modern economy, the number of such enterprises is steadily growing. At the same time there are constant changes in their organization, structure and nature of production. Many go out of business due to the loss, low profitability or other reasons have a negative impact on the economic viability of their existence.

Eliminate these negative effects and improve the effectiveness of the small private enterprises can contribute to diagnostic examination of their financial activities.

Conducting financial diagnostic, exploring the multifaceted financial activities of any economic entity, is inconceivable without the existence of the necessary conditions. In this connection it should create the necessary conditions that will ensure scientifically conducting complex procedures aimed at knowledge of the essence, and assessment of the effectiveness of the crucial financial indicators. Only in this case, financial diagnostics can provide objective materials; comprehensively characterize the company's financial activities.

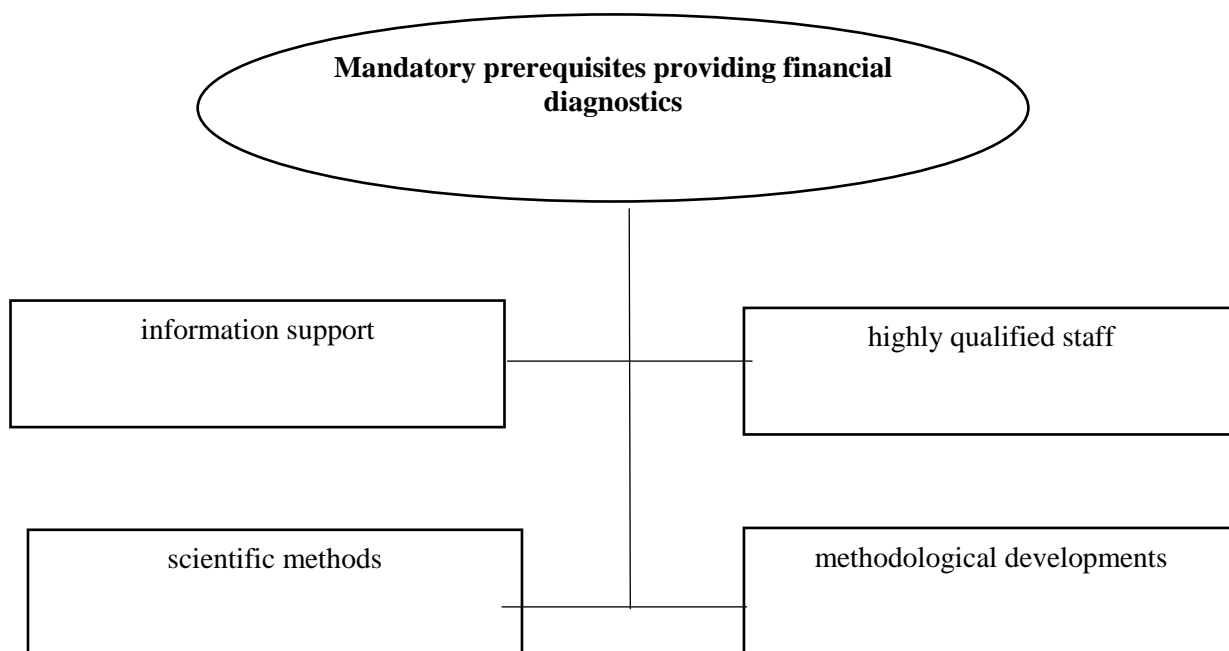
In the reality of today's economy amount of such preconditions, their species, and often the content is constantly changing. The reasons for this phenomenon lie in the increasing complexity of business processes caused by globalization and the dynamic development of the world economy. Significant changes are taking place, and at the micro level, which is reflected in the expansion, increasing complexity of economic and financial relations participants' reproduction processes.

Not coincidentally, is currently conducting financial diagnostics, which is becoming more popular, becomes very labor intensive. In such circumstances, it increases the importance of creating a mandatory prerequisite to ensure the effectiveness of financial diagnostics.

For a better recognition of the problem and its practical solutions appropriate to allocate the key areas of their implementation, without which it is impossible to become our primary goals of complex research of financial activity.

Guided by these considerations, we have a wide scope of mandatory prerequisites (presented by many authors) marked their four main groups. We believe that they play a major role in organizing and conducting financial diagnostics. The synthetic form are presented in Figure 1.

Adoption as a priority condition of having a proper information supply due to its special role in this diagnostic study. As you know, without the accumulation and



**Fig.1.** Required background providing financial diagnostics.

processing of wide range of information it is impossible to study and measurement of financial phenomena and associated economic relations. Information support base material becomes financial diagnostics and represents a selection process, accumulation and appropriate processing of accumulated data.

The totality of the information used can be classified according to different principles, which most often include: sources of income; range of issues covered; the content and methods of use of the information data.

Modern authors of a number of scientific papers on the economic financial management, lists a number of requirements for the formation of proper information support. Its essential features, in most cases, enroll such criteria as: completeness, reliability, transparency, selectivity, efficacy, and sometimes other quantitative and qualitative characteristics required of information information. It should be recognized that these requirements are relevant for the formation of information base of financial diagnostics of any business entity. However, consider it appropriate to focus attention on the main features of the information data to ensure the objective nature of financial diagnostics.

In our opinion, the solution to this problem is possible in cases where the information base:

1. To fully characterize the state, movement and impact all areas of financial activity in each phase of the operation of the business. Simultaneously, based on these data it is possible to consider the influence of internal and external factors on the deciding indicators identify deficiencies and positives financial processes.

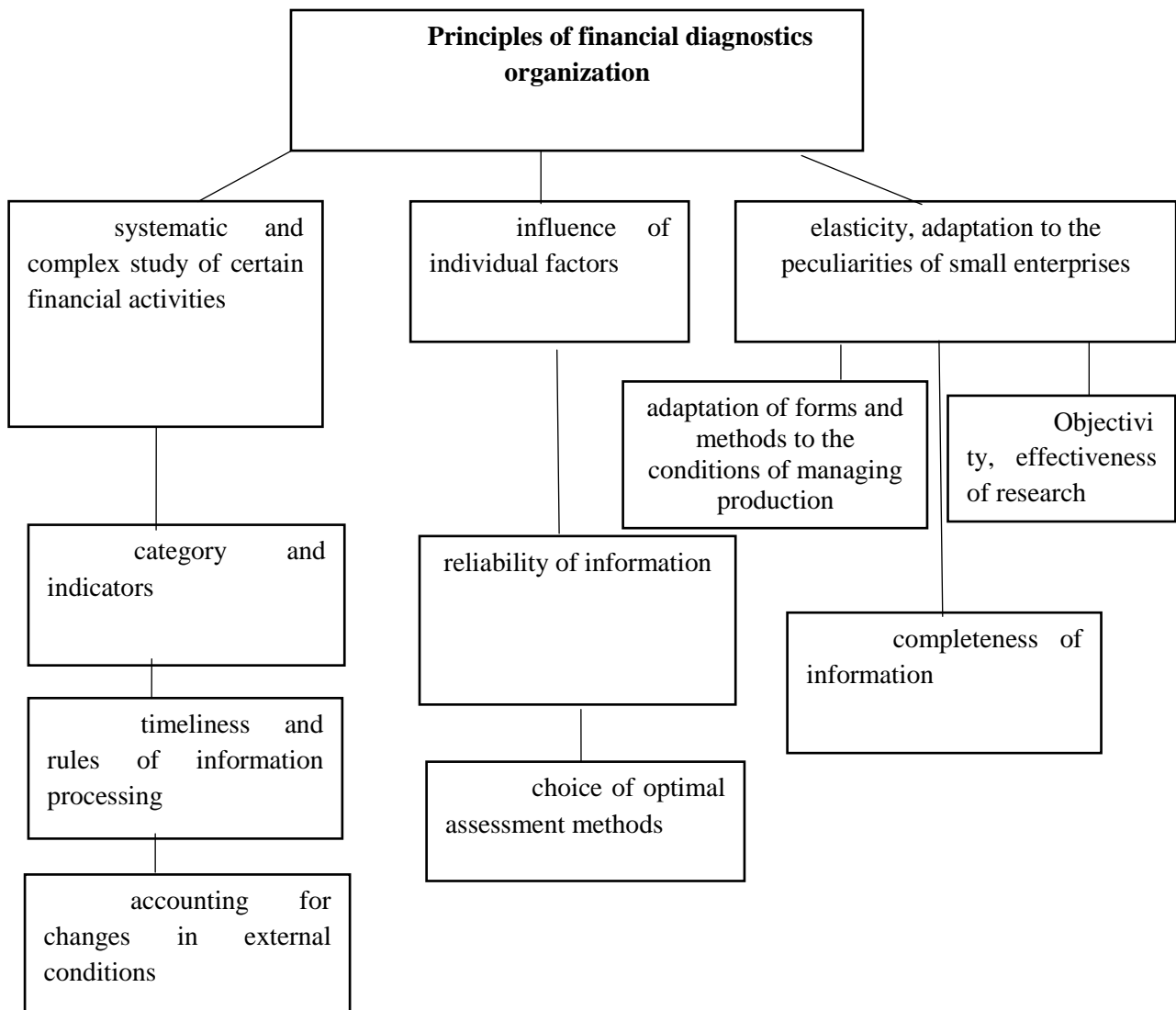
2. Is accurate, that is based on actual accounting data, financial statements, statistical data and other audited documents. At the same time necessary to observe the basic rules of drawing information data in time, space and dimension.

3. Characterized by the relevance and validity of the choice of the main criteria for the systematization of the numerous data. The principle of relevance and information support in the dynamic development of the economy and financial relations depends largely on the speed of

collecting and processing information. This process is largely due to modern technology, by which time is reduced, the amount of costs and ensures accuracy of processing numerous information data.

All the above features, which should be considered mandatory criteria for the formation of an information security for financial diagnostics, essentially reflecting its quality, in synthetic form shown on figure 2.

There is no doubt that even high-quality information provision can not become a guarantor of the deep financial objective diagnosis. The information is only an information base that is used to varying degrees, the participants of this study. Therefore, an essential prerequisite for the skillful conduct of complex research procedures, provides a comprehensive assessment of the effectiveness of functioning of the enterprise, is the availability and professionalism of the organizers and executors of these works. Since the importance of the economic literature and participating in the economic process control requirements for specialists are covered in full, we will briefly describe the basic features required of the performers of this study.



**Fig. 2.** Requirements for the Financial Information diagnostics

First of all, they include the general level of education and professionalism, which is expressed:

- in-depth knowledge of the fundamentals of general economic processes, finance, market and enterprise management mechanism based on the methodology of research of these phenomena;
- in possession of the practical skills to identify causal relationships, the application of methods for assessing the financial viability of the enterprise and forecast of its development;
- constant updating of theoretical and practical knowledge in the field of financial processes, achieve new forms of progressive methods of calculations justifying the optimal models of organization and functioning of financial activity;
- in the rational organization of the financial diagnostic process regarding the establishment of a logical sequence of the research procedures, the selection of key facilities, effective assessment methods, as well as the study and presentation of diagnostic results.

#### Methods of Financial Diagnosis

However, as has been observed, the financial diagnosis of small and medium-sized private enterprises in Azerbaijan is almost not made, and there are no guidelines for its organization. In this regard, a particularly urgent problem is the scientific substantiation of the organization and methods of financial diagnosis of small businesses. That will allow a realistic assessment of the effectiveness of the individual areas of activity and thereby prevent the occurrence of financial difficulties and the possibility of bankruptcy.

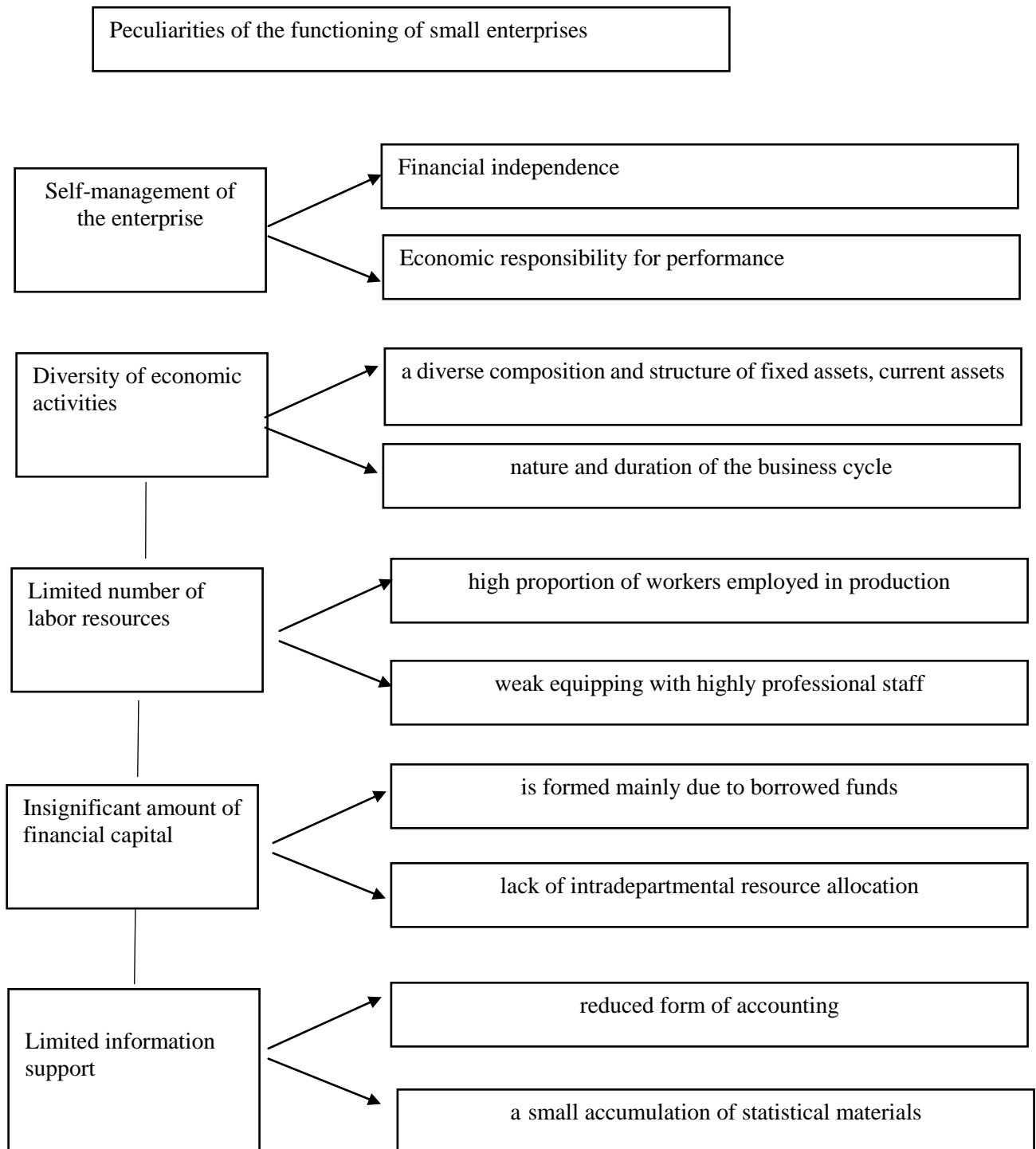
As you know, modern science offers a variety of methods for the study of economic processes at all levels of the process. The content varies depending on the space, the time, the subject of research, as well as its specific areas.

Meanwhile, in the domestic literature poorly developed theoretical and practical aspects of the financial problems of diagnosis. In fact, there are no scientific papers, in which the complex is devoted to methodological basis of financial diagnostics business activity and organization of its implementation. Only in some foreign papers, V.A. Algin [1], TI Bukhtiyarova [2] A. Vasin [3], A.Y. Petrov [4] Sh Omarova [5] G. Savchuk [6], A.P. Suvorov [7] pay attention to this topic.

In the works of E. Makinli [11], P.Lidona [12], E.Klarka [13], Dzh.Tirolia [14] and others. Authors, exploring the basics of financial management, in addition to various control methods are disclosed and methods for planning, forecasting, maneuvering financial resources aimed at the effectiveness of management services in the field of financial activity.

On the basis of theoretical generalization and practical experience of using generally accepted methods, and especially the financial diagnostic process we have tried in a systematic way to present the main methods that should be used in this process in Figure 3.

**Figure 3** summarizes the main methods used in assessing the financial performance of the enterprise. The first group are formal methods, which have received the most widespread in the financial diagnosis. This, above all, many types and forms of economic analysis, which provides the definition of the status values important financial categories, and their deviations from targets.



**Fig. 3.** Methods of diagnosis

In addition, used dynamic analysis to characterize the dynamics of the financial performance, and their changes, as well as multivariate analysis. With the help of the latter assesses the impact of the decisive factors in the value of financial indicators and their

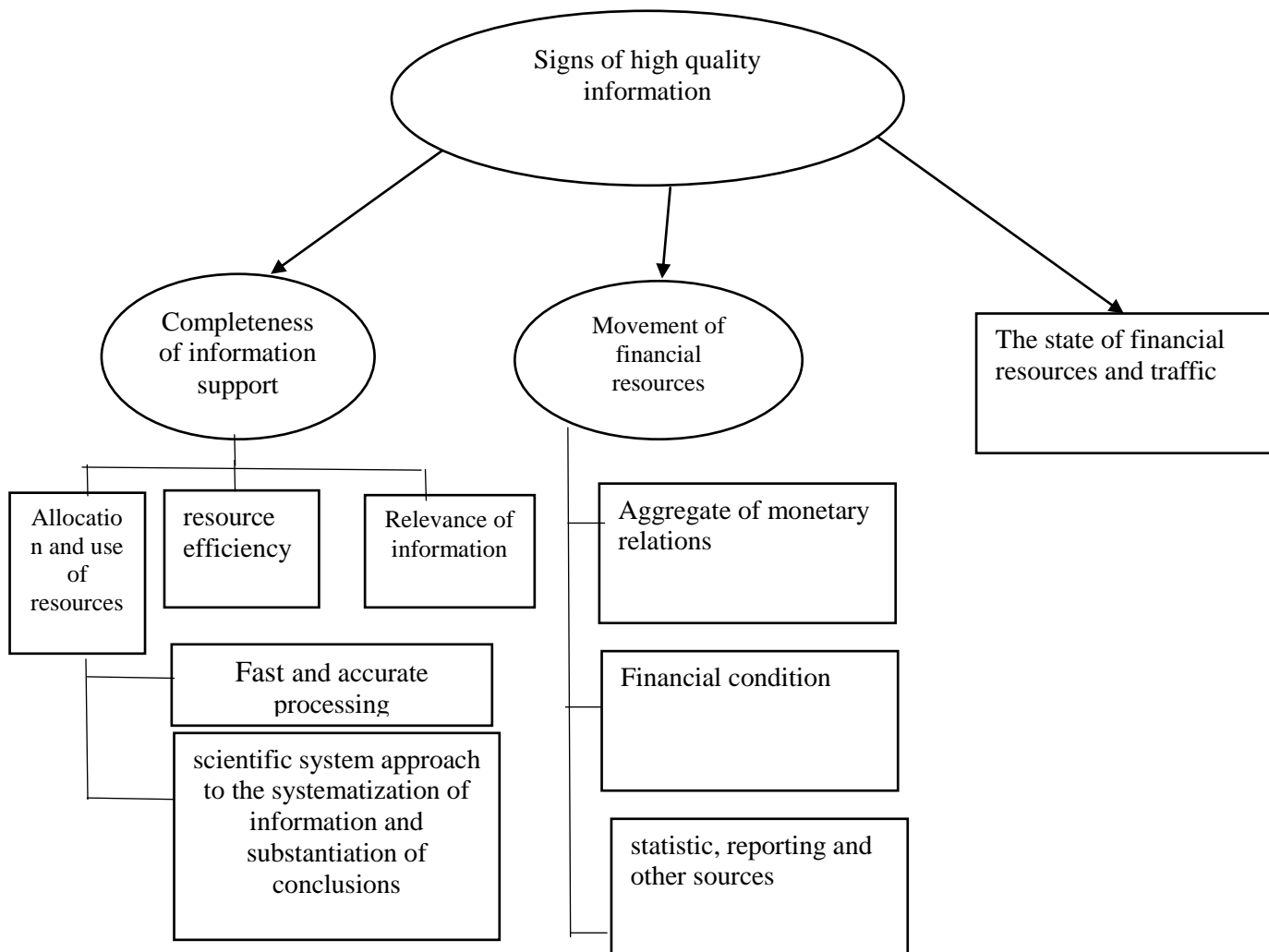
effectiveness. Considerable importance is attached to and analysis groups key financial ratios, which make it possible to assess the effectiveness of proportions,

The second group of techniques used in the process of conducting financial diagnostics, we assigned different ways to predict synthetic financial phenomena. They mainly are:

1. forecasting capabilities and rate of increase of financial resources for the proposed development of the enterprise;
2. rationale for choice of the most profitable investment projects in view of their profitability and the expected effects;
3. substantiation of optimum variants of profit maximization or other key indicators of financial activity;
4. Forecasting the company's financial position on the basis of its current activities and changes in the long term (financial situation of the company, the optimal capital structure and property, etc.).

The above methods find their application and during the financial diagnostics. However, in our view, the rationale of scientific apparatus of financial diagnostics requires a more precise definition of the aggregate of scientific methods. For this purpose it is expedient to take into account the features of the methods used in the study of general economic processes. At the same time it is necessary to take into account the specificity of the subject of financial diagnostics, goals, and tasks to be undertaken during each comprehensive study financial phenomena.

In developing this methodology should take into account the general methodological basis of an integrated approach to the study, as well as the characteristics of these business entities.





**Fig. 4.** Features of functioning of small enterprises

Features of the functioning of small and medium enterprises in Azerbaijan

On the basis of theoretical generalizations and study the functioning of small private enterprises we attempt to identify their main features. In summary, the characteristic features of the functioning of small enterprises are shown in Fig. 4.

In this sector of the economy there is no intra-redistribution of funds is limited and petty regulation of movement of financial resources from the state. The State shall regulate activity only by withdrawal mandatory payments (taxes, fees). In this situation, increased economic responsibility for rational spending of all resources, to ensure the company's solvency, ie. F. Fulfillment of financial obligations to the budget and business partners.

The second distinguishing feature of small private enterprises is possible to recognize the diversity of their economic activity, which significantly affects the composition of the structure of fixed assets, working capital, specificity and duration of the production cycle, as well as the level of costs and cash flow.

One of the most important features of these entities is to limit the amount of manpower legislation that affects the structure of personnel, their qualifications and possible use of human resources.

As a rule, small businesses in Azerbaijan in comparison with other business entities dispose of a minor amount of financial capital, which in most cases is formed at the expense of borrowed funds.

As one of the special features of the analyzed subjects should be considered and limited information support, which affects the possibilities of detail studies of certain categories. In many cases, the majority of small businesses do not accumulate statistics that allow us to investigate the causal relationships of economic indicators.

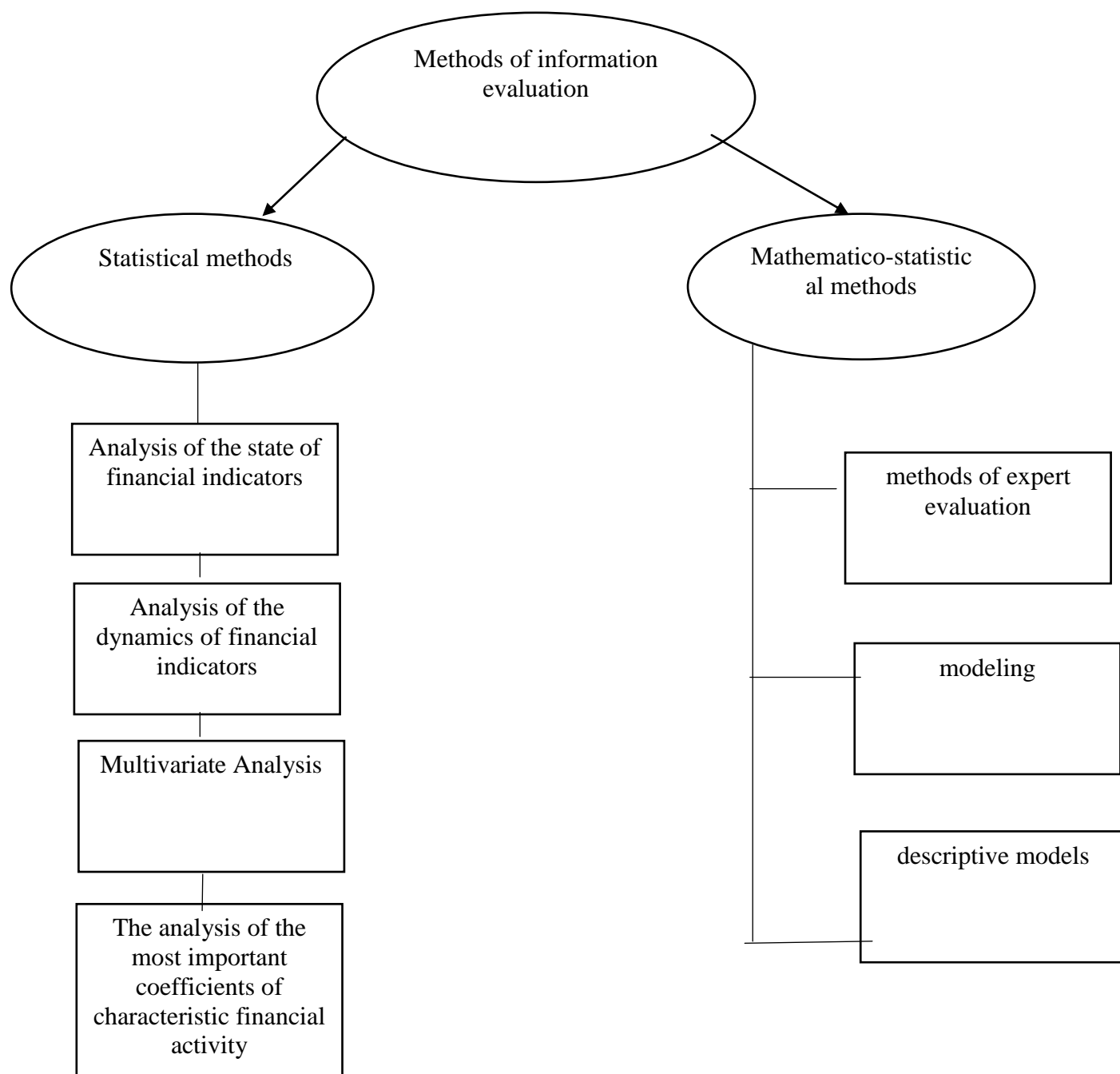
We believe that these and other aspects of the small enterprises in Azerbaijan to consider when organizing and conducting financial diagnostics, which should differ simplicity, transparency of information and provide a realistic assessment of the activities of a test subject.

In our opinion, during the financial diagnosis is of great importance to the mandatory principles of its organization, which should include: systematic and comprehensive; flexibility and objectivity of the study. Our proposed principles presented in Figure 5.

The core of the rational organization of financial diagnostics is the principle of systematic and integrated studies. This principle should be recognized as a common condition diagnostic examination of financial activity of any enterprise. Only in this case provided by a realistic assessment of outcomes of all its segments. This applies, above all, the movement of financial resources involved at all stages, stages of operation of the business, changing their form and content under the influence of many factors. Only with a comprehensive study of all areas and key indicators may identify causal relationships, identify the positive and negative developments in the industry. Compliance with this principle provides an autopsy reserves, identify certain shortcomings and positive aspects of the activity.

Principles of the organization of financial diagnostics

In our view, equally important principles of scientific organization of building financial diagnostics are: flexibility of methods and objectivity of the main findings. For the elasticity of financial diagnostics understood - the adaptation of its methods, forms to the specific conditions of farming. This refers to the clear establishment of research facilities on the basis of the possibility of obtaining information, describing their status and trends, reflecting the profile and the operating time of a particular company.



**Fig. 5.** Principles of the organization of financial diagnostics of small enterprises

At the same time flexibility should be different methods for the study and evaluation of certain financial events with the specific external and internal situation. The principle of

objectivity can be achieved only if used in the research process reliable information information that is properly classified and processed.

Based on common methodological basis for building financial diagnostics lower levels of management, set out the principles of its organization for small private enterprises, we have attempted to simulate this process.

In its most general form, shape and consistency of research procedures complete financial diagnosis of non-state small businesses are presented in Figure 5.

As seen in Figure 5, in the first place posed the problem of developing a program financial diagnostics. To solve it, you need to pre-acquainted with the alleged object of study. It is about the study of general information, how to create the company and its functioning in a particular period (the nature of the activity, the reputation of the tax authorities, credit institutions and, where possible, from individual partners). Relevant information can reasonably approach the selection of targets, research facilities, as well as the methods of its implementation.

The program defines the purpose of diagnosis and its concrete objectives. In the case of financial diagnostics is designed for the needs of small business, its purpose, as a rule, is to assess its viability and effectiveness of the overall activities.

In this case, it is first necessary to determine the effectiveness of functioning of the enterprise in terms of:

- outcomes and sustainability of the financial situation;
- determine the degree of impact of key factors on the main financial indicators;
- Opening internal reserves increase efficiency;
- identify concrete ways to address identified deficiencies, activating cost of leverage,

and on this basis to improve the efficiency of use of financial resources.

#### Conclusion

As our research, in the current conditions the objective of financial diagnosis of small and medium-sized enterprises used for external use (different partners, investors, creditors), is to assess the company's financial position, its financial capabilities timely implementation of economic commitments, as well as its further development. The second stage of the organization of the financial diagnosis remains the creation of information systems. This problem is relevant to all enterprises irrespective of the form and type of activity. In this regard, it should be noted that the general accounting data and the scarcity of statistical data accumulated by small businesses, make it difficult to determine the degree of influence of various factors on the effectiveness of all areas of financial activity. In the third stage, the study and evaluation of the object of study. In the fourth stage we justify the overall capacity and performance of the company, made up of its rating.

A variety of methods are adopted in the financial diagnosis, is formed in the whole of its scientific apparatus. Use, which depends largely on the scientific approach to the selection of the most effective methods and skillful use of them. On the solution of this problem can have a positive impact of methodological developments on financial diagnosis, which should largely depend on the specific types of business entities, as well as the forms of planned diagnostic study.

The principles we have developed diagnostic test is offered in a logical sequence to analyze the state, dynamics and structure of the key areas of financial activity. Since the material basis are the financial resources, the utmost attention is paid to their movement, from the stage of creation of the enterprise, where resources take the form of primary capital.

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